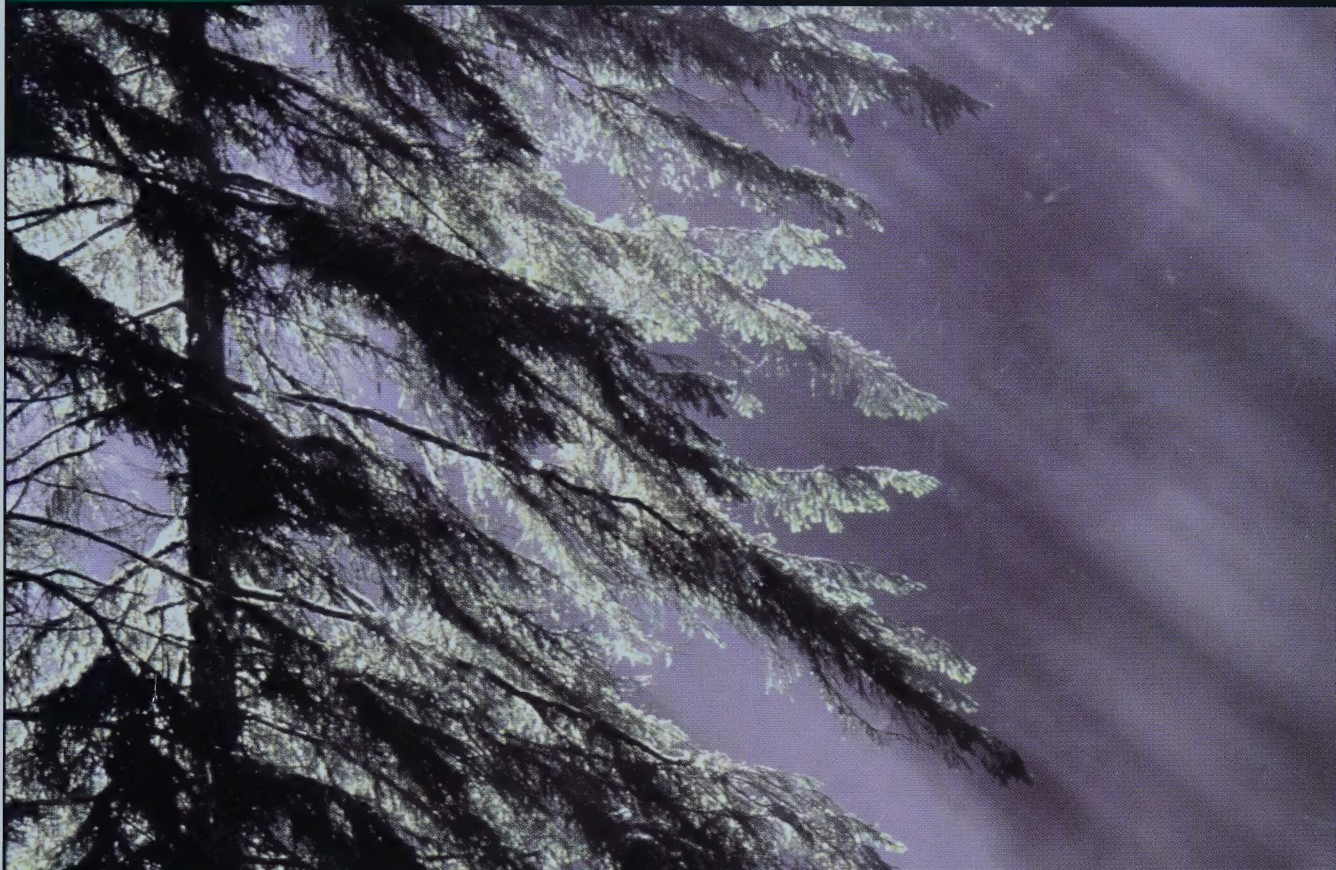


STORM ENERGY INC.



CLEAR VISION... FORWARD THINKING

1997

ANNUAL REPORT



## CORPORATE PROFILE

Storm Energy Inc. is a rapidly growing, Calgary based, junior oil and gas exploration and production company. In June, 1997, Storm Energy Corporation acquired a major interest in Dancap Resources Inc. via a reverse takeover and the two companies were amalgamated on October 31, 1997 under the name Storm Energy Inc. Storm has grown dramatically over the past two years as evidenced by the increase in production from 17 Boe/d in November, 1994 to 2,350 Boe/d at 1997 year-end. While the Company is primarily focused on conventional light, crude oil exploration, development and production in Alberta, future plans include a larger exposure to natural gas. Storm currently employs a staff of 13 experienced, successful, and highly motivated people. The common shares of Storm trade on the Alberta Stock Exchange under the trading symbol "SME".

## NOTICE

The Annual and Special Meeting of Shareholders will be held at 2:30 p.m. on Thursday, May 14, 1998, in the Glencoe Room, Calgary Convention Centre, 120 - 9th Avenue S.E., Calgary, Alberta. All shareholders and other interested parties are encouraged to attend.

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## ABBREVIATIONS USED IN THIS REPORT

|        |                                                                                                       |
|--------|-------------------------------------------------------------------------------------------------------|
| ARTC   | Alberta Royalty Tax Credit                                                                            |
| Bcf    | Billions of cubic feet                                                                                |
| Boe    | Barrels of oil equivalent<br>(10,000 cubic feet of natural gas being equivalent to one barrel of oil) |
| Boe/d  | Barrels of oil equivalent per day                                                                     |
| Bbl    | Barrel of oil or natural gas liquids                                                                  |
| Bbl/d  | Barrels per day                                                                                       |
| Mbbl   | Thousands of barrels                                                                                  |
| Mboe   | Thousands of barrels of oil equivalent                                                                |
| Mcf    | Thousands of cubic feet                                                                               |
| Mcf/d  | Thousands of cubic feet per day                                                                       |
| Mmcf   | Millions of cubic feet                                                                                |
| Mmcf/d | Millions of cubic feet per day                                                                        |
| Mstb   | Thousand stock tank barrels                                                                           |
| NGL    | Natural Gas Liquids                                                                                   |



# HIGHLIGHTS

|                                      | Twelve months<br>ended<br>December 31,97 | Nine months<br>ended<br>December 31,96 | Annualized<br>% Change |
|--------------------------------------|------------------------------------------|----------------------------------------|------------------------|
| <b>FINANCIAL</b>                     |                                          |                                        |                        |
| Revenues                             | \$13,791,968                             | \$2,656,570                            | 289                    |
| Cash Flow from operations            | 7,054,046                                | 1,348,081                              | 292                    |
| Per share (basic)                    | 0.152                                    | 0.063                                  | 141                    |
| Per share (fully diluted)            | 0.122                                    | 0.047                                  | 160                    |
| Net Income                           | 1,001,415                                | 500,793                                | 50                     |
| Per share (basic)                    | 0.022                                    | 0.023                                  | (4)                    |
| Capital expenditures                 | 38,573,720                               | 4,483,233                              | 545                    |
| Working capital deficit (surplus)    | 1,511,604                                | 52,539                                 | -                      |
| Bank indebtedness                    | 15,000,000                               | Nil                                    | -                      |
| Common shares outstanding (millions) |                                          |                                        |                        |
| Weighted Average - Basic             | 46.5                                     | 21.6                                   | 115                    |
| Weighted Average - Fully Diluted     | 57.7                                     | 27.5                                   | 102                    |
| <b>OPERATIONS</b>                    |                                          |                                        |                        |
| Average daily production             |                                          |                                        |                        |
| Crude oil and NGLs (Bbl/d)           | 1,462                                    | 414                                    | 253                    |
| Natural gas (Mcf/d)                  | 655                                      | 40                                     | 1538                   |
| Barrels of oil equivalent (Boe/d)    | 1,527                                    | 418                                    | 265                    |
| Average product prices               |                                          |                                        |                        |
| Crude oil (\$/Bbl)                   | 25.27                                    | 25.70                                  | (2)                    |
| Wells drilled                        |                                          |                                        |                        |
| Gross                                | 17.00                                    | 6.00                                   | 183                    |
| Net                                  | 11.82                                    | 4.98                                   | 137                    |
| Success rate (%)                     | 64                                       | 80                                     | -                      |
| Reserves - proved and probable       |                                          |                                        |                        |
| Crude oil and NGLs (Mstb)            | 4,784                                    | 1,637                                  | 192                    |
| Natural gas (Mmcf)                   | 6,175                                    | 3,061                                  | 102                    |
| Barrels of oil equivalent (Mboe)     | 5,402                                    | 1,943                                  | 178                    |



# R E P O R T T O S H A R E H O L D E R S



I am pleased to present the 1997 Annual Report for Storm Energy Inc. The past year can be characterized as one of significant corporate change and growth for Storm. On May 30, Storm Energy Corporation purchased a producing oil property in the Evi area of Alberta for \$23.3 million net of adjustments. The effective date of the transaction was March 1, 1997 and at the time of the closing the

property was producing approximately 1,100 Bbl/d of light, sweet crude. In addition to the production, Storm acquired 14,400 gross (8,076) net acres of land, an interest in three separate production facilities and gathering systems, and access to 40 square miles of 3D data. To finance the acquisition, the Company issued 8,450,000 special warrants for gross proceeds of \$13,520,000 with the remainder financed through bank debt.

On June 11, 1997, Storm Energy Corporation gained control of Dancap Resources Inc. via a reverse takeover whereby Dancap purchased all of the issued and outstanding common shares and options of Storm Energy Corporation on the basis of 2.13725 Dancap shares for each common share or common share option of Storm. At the annual meeting held in September, Dancap shareholders approved a change in name from Dancap Resources Inc. to Storm Energy Inc.

On October 31, 1997, Storm became the sole owner of Long Reef Resources Inc., a private company, by purchasing the outstanding 50% interest in Long Reef for \$50,050. On the same date, Storm Energy Inc., Storm Energy Corporation and Long Reef Resources Inc., amalgamated under the name Storm Energy Inc.

## OPERATING RESULTS

Through a combination of acquisitions and drilling, Storm's exit production reached 2,350 Boe/d, an increase of 386% from the 485 Boe/d recorded in 1996. With another 2 Mmcf/d behind pipe, the Company achieved its revised target of 2,500 Boe/d of production potential entering into 1998. Crude oil and liquids production averaged 1,462 Bbl/d, gas averaged 655 Mcf/d giving a corporate average production rate of 1,527 Boe/d for the year. The Company enjoyed its busiest year ever, drilling a total of 17 wells (11.82 net) with a success rate of 64%. Storm had excellent drilling success at Evi with six productive oil wells in seven attempts. At year end, proved and probable reserves totalled 5,401.5 Mboe, an increase of 178% over the previous year.

Operating costs for 1997 decreased to \$4.95/Boe from \$5.55 in the previous year. Further decreases in operating costs are expected in 1998 as Storm adds new facilities and upgrades the present infrastructure on existing properties. The 4-36 facility at Evi is now operational and Storm expects operating costs in this area to drop by \$1-\$2/Bbl.



## FINANCIAL RESULTS

On an annualized basis, revenues rose to \$13,791,968 up 289% from the figure recorded in 1996. The increase resulted primarily from the Evi acquisition and the successful drilling program undertaken at Evi throughout the year. Cash flow from operations was \$7,054,046, an increase of 292% from the previous year's figure. Storm achieved a cash flow netback of \$12.66/Boe despite the softening of oil prices in the last half of the year. The Company received an average price of \$24.75/Boe in 1997 compared to \$25.70/Boe reported in 1996.

Capital expenditures reached \$38.6 million with the Evi and Dancap acquisitions accounting for \$27.2 million of the total. Drilling costs totalled \$6.0 million, equipment and facility costs were \$3.7 million, with land, seismic and associated costs contributing another \$1.7 million in capital expenditures. Included in these costs were the construction of a new oil processing facility at Evi and the compilation of a large land position in areas adjacent to Evi. As of December 31, 1997, Storm had 95,833 gross acres (53,867 net) of developed and undeveloped land, an increase of 259% from last year's total.

## LOOKING AHEAD

As 1997 drew to a close, certain world events took place that adversely affected financial markets, including oil and gas stocks. These included the currency crisis in Asia, the Kyoto summit, OPEC's decision to raise oil production quotas, and the ongoing situation in Iraq. As a result, oil prices have declined almost 40% from their corresponding 1997 levels and most companies, including Storm, have revised their 1998 cash flow and capital expenditure forecasts accordingly. Concurrently, companies with production weighted towards natural gas are gaining favor with investors because of an expected increase in gas prices as additional pipeline capacity into the United States becomes available.

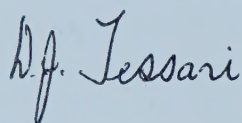
Storm agrees that the present level of world oil prices is cause for concern but not panic. The oil and gas industry is cyclical in nature and history has shown that the prices of both commodities are subject to wide variations over time. In March 1998, a leading energy investment firm in Calgary estimated that crude oil prices would average US\$17/Bbl and natural gas wellhead prices would average C\$1.70/Mcf for the year with an exchange rate of C\$0.70. This translates into an average Edmonton par price for oil of more than \$21/Bbl which equates to a gas price of \$2.10/Mcf on a Boe basis. The Boe comparison shows that light oil producers like Storm can expect 1998 netbacks per Boe to be comparable to, or better than, the netbacks realized by natural gas producers, given the price scenarios above and assuming other factors such as operating costs and royalties have a neutral impact on netbacks.

Storm's plans for this year include activities designed to increase the Company's exposure to natural gas as well as to maintain a strong position in light, sweet oil. The Company is well positioned for growth having assembled a large inventory of land and 3D seismic in 1997. Activities in 1998 will be focused in four main areas. Three of these areas (Evi/Kitty, Seal/Dawson, Ogston) are located on the Peace River Arch. All of these areas are prospective for light, sweet oil and two are prospective for shallow gas. Storm also has a large 150 Bcf gas play in the foothills northwest of Calgary. Further details on the activities planned for all four areas are given later in this annual report.

In other projects, the two shut-in gas wells at Grand Forks are scheduled for tie-in early in May and they should add about 2 Mmcf/d (200 Boe/d) to Storm's total production. The Company plans to upgrade the oil handling and water disposal facilities at Loon to allow the trucking of clean oil to the Evi facility thereby reducing operating costs in the area. Storm also has land and production in several areas in Southern and Central Alberta. While these areas will not receive priority in 1998, Storm plans to drill one exploratory well in Southern Alberta later in the year.

I would like to take this opportunity to thank Storm's staff, directors, and contract operators for their contributions to our growth in 1997. To our valued shareholders, we thank you for your support over the past year and look forward to your continued support in 1998.

On behalf of the Board of Directors

A handwritten signature in dark ink, reading "D.J. Tessari". The signature is written in a cursive style with a large, stylized "T".

Daniel J. Tessari

President and Chief Executive Officer

March 11, 1998



## C O R P O R A T E   S T R A T E G Y

The foundation of Storm's strategy is to maintain a production level that provides a solid cash flow base to help fund future exploration and development activities. The Company has successfully built this base primarily from high netback, light oil production and plans to maintain it through further development and exploitation activities on existing properties.

A second strategic component is to control infrastructure and facilities in the Company's core areas. For example, Storm now has a competitive advantage in the Evi area because of control over facilities. In addition, Storm operates about 65% of its production and will strive to maintain operatorship and a high working interest in properties whenever feasible.

Storm believes it is prudent to strike a reasonable balance between oil and gas production to take advantage of changing market conditions. Storm has a deep gas play in the foothills northwest of Calgary as well as shallow gas potential on their Peace River Arch lands. Storm intends to pursue both plays this year.

To assure growth, Storm knows the importance of having a sufficiently large land base to allow for the generation of future oil and gas prospects. In addition, the Company believes in the use of 2D and 3D seismic to pinpoint exploration and development trends more precisely. Storm has an excellent inventory of prospects and a large seismic data base that will enable it to concentrate on internally generated prospects in 1998 and beyond.

## A R E A S   O F   F O C U S F O R   1 9 9 8

Storm has identified four major areas for exploration and development activity in 1998. Three of these high impact prospects are located on the Peace River arch and the fourth is situated in the foothills northwest of Calgary. The prospects are consistent with Storm's growth strategy of pursuing light, sweet, high netback oil, increasing Storm's natural gas production and reserves, and utilizing existing Storm facilities most notably those in the Evi/Kitty area.



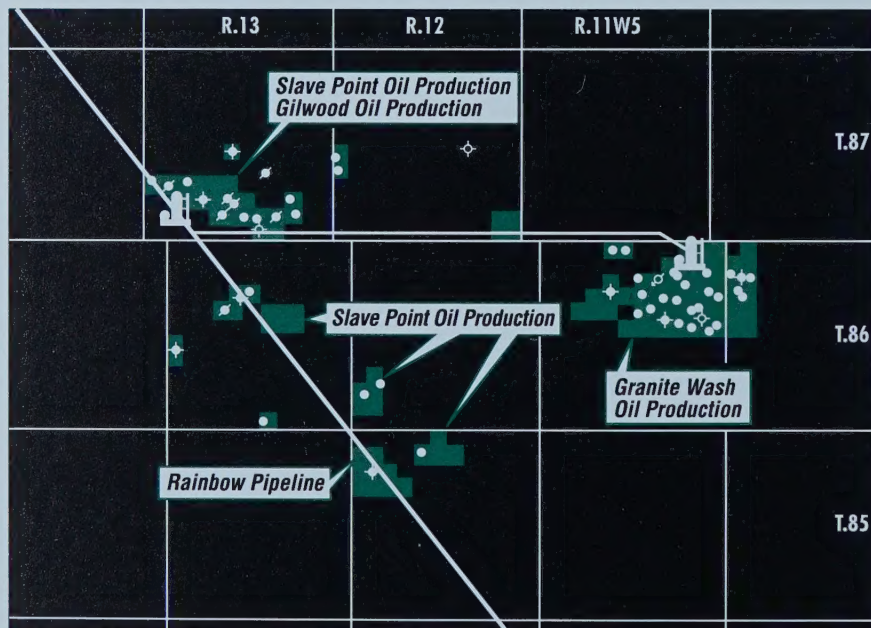


## Evi/Kitty

During 1997 Storm established a new core area at Evi/Kitty in northern Alberta through strategic production acquisitions, development drilling, facility construction, 3D seismic acquisition, and crown land purchases. To date, Storm has an interest in 42 producing wells in the area varying in working interest from 42% to 100% with the average being 58%. Total production from the area at the beginning of 1998 was 1550 Bbl/d of light sweet oil (39 degree API) from the Granite Wash, Gilwood and Slave Point Formations. The Company operates over 65% of these wells and has ownership in two major processing facilities and associated gathering and water disposal systems. With access to these facilities, land holdings in the area of 16,290 gross acres (9,890 net acres), and access to approximately 100 square miles of 3D seismic, Storm will continue to be a major player in the greater Evi/Kitty region. Current plans call for the drilling of seven to ten wells in this area in 1998.

### Legend

-  Pipeline
-  Storm Land
-  Storm Wells
-  Storm Oil Facility





### Dawson/Seal

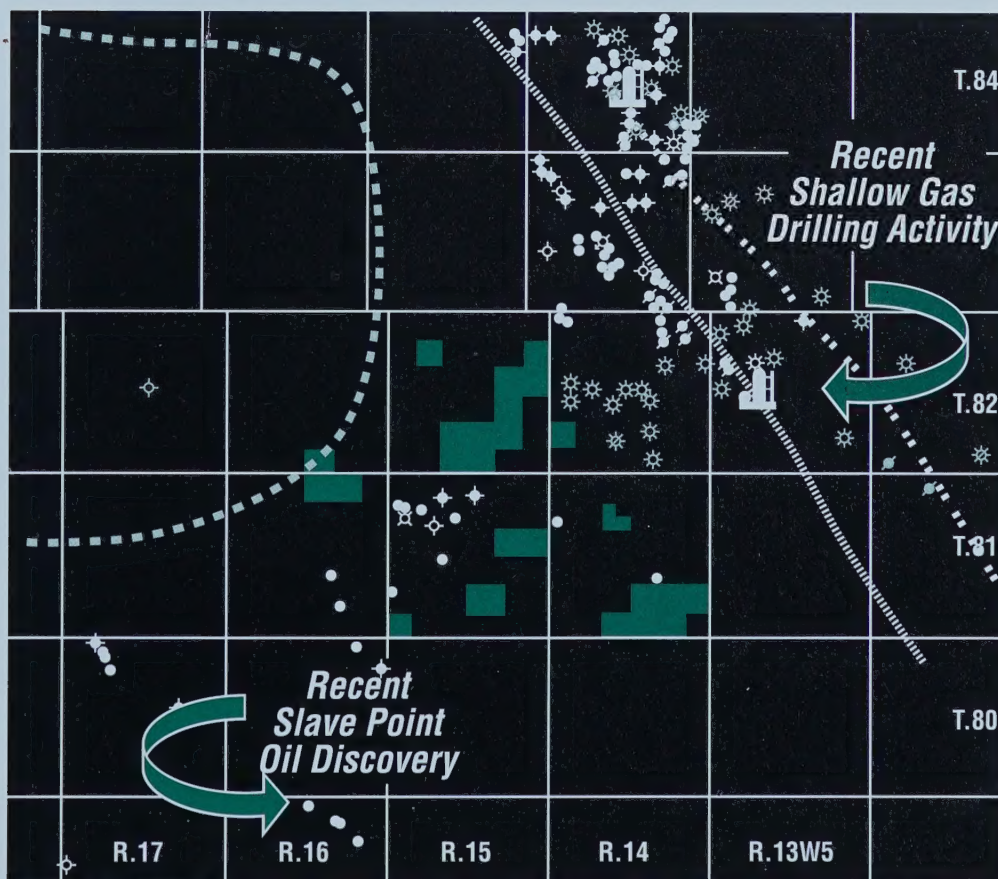
The Dawson/Seal area is highly prospective for light quality Slave Point oil and prolific shallow Mississippian gas, as evidenced by recent activity in the area. This activity has already yielded many high rate (400 to 800 Bbl/d) oil wells from the Slave Point formation and Mississippian gas wells with production of 3-5 Mmcf/d.

Storm Energy Inc. has entered into a joint venture to explore this area on trend with the recent discoveries. The joint venture currently has access to 23 sections of land and 25 square miles of 3D seismic. The Company expects to be active in this area in 1998 with the drilling of three to five wells and the shooting of additional seismic. Several drilling locations have already been identified and the first well spudded mid February 1998. Storm has a 45% non-operated working interest in the joint venture.

### Legend

--- Peace River Arch  
--- Multiple Mississippian Subcrops

■ Storm Land  
○ Mississippian Producers  
○ Slave Pt. Producers  
🏠 Gas Plants



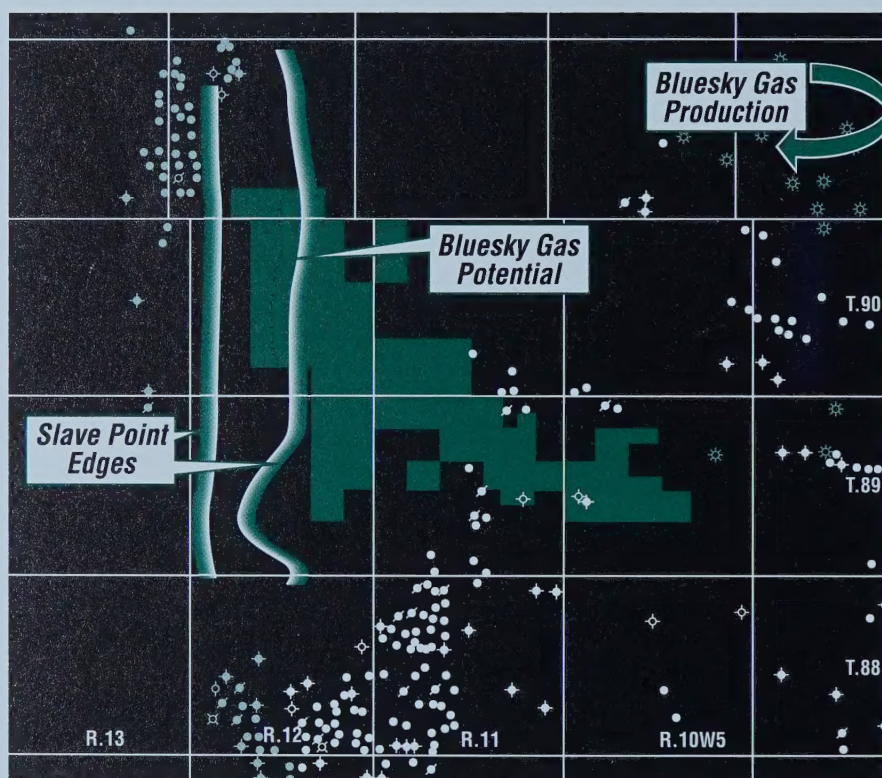


## Ogston

Storm has access to over 56 sections of land in the Ogston area. This area is prospective for oil production from the Slave Point and Granite Wash formations as well as Bluesky gas. Storm has completed its first 3D program here comprised of 11 square miles of data. This supplements 12 square miles of 3D data acquired from a partner. All three zones will be evaluated for their potential this summer with drilling slated to commence later this year. Storm has a 50% working interest in this area.

### Legend

- Storm Land
- Bluesky Production
- Granite Wash Production
- Slave Point Production



## Foothills Area

On the gas side, Storm has accumulated 20 sections of land over a 150 Bcf foothills play northwest of Calgary. The target formation has been defined by previous drilling and has produced non-commercial amounts of gas. The Company plans to drill this prospect in the spring of 1998 using new technology to provide economic production rates and access to this large reserve potential. If the first well is successful, Storm plans to drill two or three more wells later in 1998 or early 1999. Storm holds a 100% operated working interest in most of the lands with an average working interest of approximately 75%.



## PRODUCTION & ACTIVITY REVIEW

The map below shows Storm's Alberta properties, the 1997 exit production rate, the number of gross wells drilled in each area in 1997, and the drilling success in each area.





# REVIEW OF OPERATIONS

Storm drilled a total of 17 wells (11.82 net) in 1997. The Company was most active in the Evi area drilling six successful oil wells in seven attempts. The remainder of the drilling activity took place in Central and Southern Alberta. In Central Alberta, Storm drilled a total of four (gross) wells resulting in three oil producers and one capped gas well. In Southern Alberta, Storm drilled six (gross)

wells, one successful gas well while the others were dry and abandoned. Storm's total land holding increased 259% during 1997 to 95,833 (gross) acres with undeveloped acreage representing 76% of the total. The Company's 3D seismic inventory increased to 132 square kilometers, up 230%, while the 2D inventory rose 259% to 406 kilometres.

## DRILLING ACTIVITY

|                          | Twelve months ending<br>Dec. 31, 1997 |       | Nine months ending<br>Dec. 31, 1996 |      | Twelve months ending<br>Mar. 31, 1996 |     |
|--------------------------|---------------------------------------|-------|-------------------------------------|------|---------------------------------------|-----|
|                          | Gross                                 | Net   | Gross                               | Net  | Gross                                 | Net |
| Oil                      | 9.0                                   | 6.02  | 3.0                                 | 2.35 | 1.0                                   | 1.0 |
| Gas                      | 2.0                                   | 1.50  | 2.0                                 | 1.63 | —                                     | —   |
| Dry and Abandoned        | 6.0                                   | 5.30  | 1.0                                 | 1.00 | 1.0                                   | 1.0 |
| Total                    | 17.0                                  | 11.82 | 6.0                                 | 4.98 | 2.0                                   | 2.0 |
| Success Ratio            | 65%                                   | 64%   | 83%                                 | 80%  | 50%                                   | 50% |
| Average Working Interest | 70%                                   |       | 83%                                 |      | 100%                                  |     |

## PRODUCTION BY AREA (Average)

|                   | Twelve months ending<br>Dec. 31, 1997 |                | Nine months ending<br>Dec. 31, 1996 |                | Twelve months ending<br>March 31, 1996 |                |
|-------------------|---------------------------------------|----------------|-------------------------------------|----------------|----------------------------------------|----------------|
|                   | Oil<br>(Bbl/d)                        | Gas<br>(Mcf/d) | Oil<br>(Bbl/d)                      | Gas<br>(Mcf/d) | Oil<br>(Bbl/d)                         | Gas<br>(Mcf/d) |
| Grand Forks/Hays  | 290                                   | 355            | 279                                 | —              | 233                                    | —              |
| Skaro             | 72                                    | —              | 33                                  | —              | —                                      | —              |
| Red Willow        | 90                                    | 300            | 62                                  | —              | —                                      | —              |
| Evi/Kitty         | 1,010                                 | —              | —                                   | —              | —                                      | —              |
| Total Average     | 1,462                                 | 655            | 374                                 | 40             | 233                                    | 20             |
| Exit Rate (Boe/d) | 2,350                                 |                | 485                                 |                | 205                                    |                |



**LAND HOLDINGS (acres)**

|             | As at Dec. 31, 1997 |        | As at Dec. 31, 1996 |        |
|-------------|---------------------|--------|---------------------|--------|
|             | Gross               | Net    | Gross               | Net    |
| Developed   | 23,257              | 10,492 | 7,962               | 3,376  |
| Undeveloped | 72,576              | 43,375 | 18,730              | 17,303 |
| Total       | 95,833              | 53,867 | 26,692              | 20,679 |

**SEISMIC INVENTORY**

|                            |                      | As at Dec. 31 | As at Dec. 31 |          |
|----------------------------|----------------------|---------------|---------------|----------|
|                            |                      | 1997          | 1996          | % Change |
| 3-D Seismic<br>(Square km) | Proprietary          | 44            | 22            | 100      |
|                            | Purchased Trade Data | 88            | 18            | 388      |
|                            | Total                | 132           | 40            | 230      |
| 2-D Seismic<br>(km)        | Proprietary          | 19            | 11            | 73       |
|                            | Purchased Trade Data | 387           | 102           | 279      |
|                            | Total                | 406           | 113           | 259      |

**CRUDE OIL AND NATURAL GAS RESERVES**

The reserves of Storm's petroleum and natural gas properties were evaluated as at December 31, 1997 by D.L. Paddock and Associates ("Paddock"), independent petroleum engineers. The following tables provide information based upon the figures contained in the Paddock report dated January 8, 1998.

**COMPANY'S NET RESERVES**

|                            | Oil & NGL's<br>(Mstb) | Sales Gas<br>(Mmcf) | Mboe<br>(@ 10:1) |
|----------------------------|-----------------------|---------------------|------------------|
| Proved Producing           | 3,537                 | 779                 | 3,614.9          |
| Proved Non-Producing       | 271                   | 3,897               | 660.7            |
| Total Proved Developed     | 3,808                 | 4,696               | 4,275.6          |
| Proved Undeveloped         | 148                   | 0                   | 148.0            |
| Total Proved               | 3,956                 | 4,676               | 4,423.6          |
| Probable (Unrisked)        | 828                   | 1,499               | 977.9            |
| Proved + Probable Unrisked | 4,784                 | 6,175               | 5,401.5          |
| Reduction For Risk         | ( 414)                | ( 749)              | ( 488.9)         |
| Proved + Probable Risked   | 4,370                 | 5,426               | 4,912.6          |



## 1997 RESERVES RECONCILIATION

(Before Royalties)

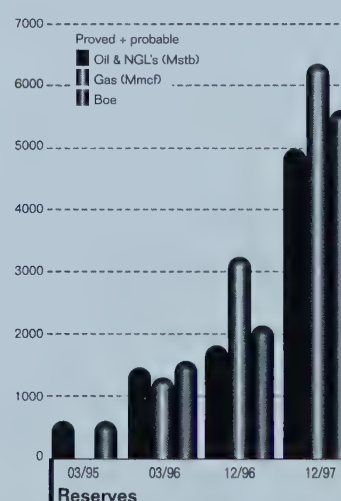
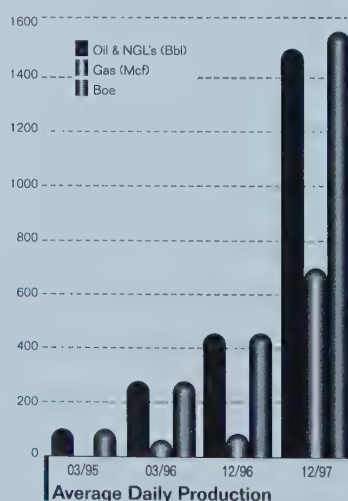
|               | Crude Oil & NGLs (Mstb) |          |       | Natural Gas (Mmcf) |          |       | Mboe (@ 10:1) |          |           |
|---------------|-------------------------|----------|-------|--------------------|----------|-------|---------------|----------|-----------|
|               | Proved                  | Probable | Total | Proved             | Probable | Total | Proved        | Probable | Total     |
| At Dec. 31/96 | 1,121                   | 516      | 1,637 | 2,208              | 853      | 3,061 | 1,341.8       | 601.3    | 1,943.1   |
| Discoveries   | 685                     | 180      | 865   | 1,698              | 691      | 2,389 | 854.8         | 249.1    | 1,103.9   |
| Acquisitions  | 3,351                   | 449      | 3,800 | 1,284              | —        | 1,284 | 3,479.4       | 449.0    | 3,928.4   |
| Production    | (534)                   | —        | (534) | (236)              | —        | (236) | (557.6)       | —        | (557.6)   |
| Revisions     | (667)                   | (317)    | (984) | (278)              | (45)     | (323) | (694.8)       | (321.5)  | (1,016.3) |
| At Dec.31/97  | 3,956                   | 828      | 4,784 | 4,676              | 1,499    | 6,175 | 4,423.6       | 977.9    | 5,401.5   |

## CUMULATIVE RESERVES RECONCILIATION (1994-1997)

(Before Royalties)

|              | Crude Oil & NGLs (Mstb) |          |         | Natural Gas (Mmcf) |          |       | Mboe (@ 10:1) |          |           |
|--------------|-------------------------|----------|---------|--------------------|----------|-------|---------------|----------|-----------|
|              | Proved                  | Probable | Total   | Proved             | Probable | Total | Proved        | Probable | Total     |
| At Nov. 1/94 | 0                       | 0        | 0       | 0                  | 0        | 0     | 0             | 0        | 0         |
| Discoveries  | 1,794                   | 854      | 2,648   | 3,376              | 1,544    | 4,920 | 2,131.6       | 1,008.4  | 3,140.0   |
| Acquisitions | 3,648                   | 454      | 4,102   | 1,835              | 0        | 1,835 | 3,831.5       | 454.0    | 4,285.5   |
| Production   | (730)                   | —        | —       | (258)              | —        | (258) | (755.8)       | —        | (755.8)   |
| Revisions    | (756)                   | (480)    | (1,236) | (277)              | (45)     | (322) | (783.7)       | (484.5)  | (1,268.2) |
| At Dec.31/97 | 3,956                   | 828      | 4,784   | 4,676              | 1,499    | 6,175 | 4,423.6       | 977.9    | 5,401.5   |

Storm added 865 Mstb of proven and probable oil reserves primarily through drilling at Evi and 2.39 Bcf of gas reserves at Grand Forks and Virginia Hills. Reserves of 4,286 Mboe were realized through the Evi and Long Reef acquisitions and the reverse take-over of Dancap Resources Inc. Proven and probable reserve revisions of (1,268) Mboe occurred when undeveloped wells and unexpected production declines were realized in Retlaw, Long Coulee and Hays. Development plans for these Southern Alberta lands are on hold pending further technical review and the recovery of Bow River medium oil pricing.





# MANAGEMENT'S DISCUSSION & ANALYSIS

*(Percent changes have been annualized for comparative purposes)*

## STATEMENT OF OPERATIONS

### Oil and Gas Revenue

Storm's revenues from oil and gas sales before royalties increased 289% to \$13,791,968 compared to \$2,656,570 for the nine month period in 1996. This increase was primarily due to a 253% increase in oil production volumes in 1997 compared to the volumes for the previous year. Although total gas production increased in 1997, the impact of this increase on total revenues was not as significant. The selling price for oil in 1997 averaged \$25.27/Bbl, down 2% from the \$25.70/Bbl in 1996. The lower price realized in 1997 can be contributed to the weakening of the West Texas Intermediate price late in the year and the negative impact of the widening price differential on Storm's production that was sold into the Bow River system. Storm received an average price of \$1.65/Mcf in 1997 as compared to \$1.31/Mcf in 1996.

### Royalties

Storm's royalties increased to \$3,022,348 million, up 210% from \$730,295 in 1996. This increase resulted from the large increase in oil production during the past year, higher Crown royalty rates on increased production rates per well, and increased overriding royalties on new production. On a Boe basis, royalties in 1997 were \$4.85, up 8% from the \$4.49 in 1996. The 1997 ARTC reduction in royalties was \$321,425 compared to \$263,557 last year. The ARTC reduction decreased by 9% on an annualized basis because of a 20% decrease in the ARTC rate and because the majority of production additions during 1997 were on non-eligible ARTC properties.

### Production Expenses

Production expenses reached \$3,009,002 in 1997, an increase of 291% over 1996 costs. When converted to a unit cost, production expenses were \$4.95/Boe, down 11% from \$5.55 in 1996. This unit decrease can be contributed to the lower operating costs associated with the Evi oil production which averaged \$4.25/Boe in 1997 and the benefits reaped from facility expenditures incurred in late 1996.

### General and Administrative

1997 general and administrative costs were \$817,012 compared to \$279,821 in 1996. Included in this total were interest expenses of \$184,797 related to the Evi acquisition. In addition to the interest expense, the increase is a result of office and staff expansions that were needed because of the corporate changes and significant growth that was realized during the year. On a unit basis, general and administrative costs dropped 83% to \$1.47/Boe compared to \$2.69/Boe last year. A total of \$343,423 of general and administrative costs directly related to exploration activities were capitalized in 1997 compared to \$138,750 in the previous period. This increase was due to expanding the exploration staff to four, an increase in geophysical consulting, and a one-time retirement allowance payment made during the year.



### Interest on Long Term Debt

Storm's interest cost on long term debt was \$399,482 based on an average interest rate of 5.2%. For 1997, debt costs were \$0.72/Boe. There are no comparable figures for 1996 as the company was debt free. The Company does not capitalize interest.

### Cash Flow From Operations

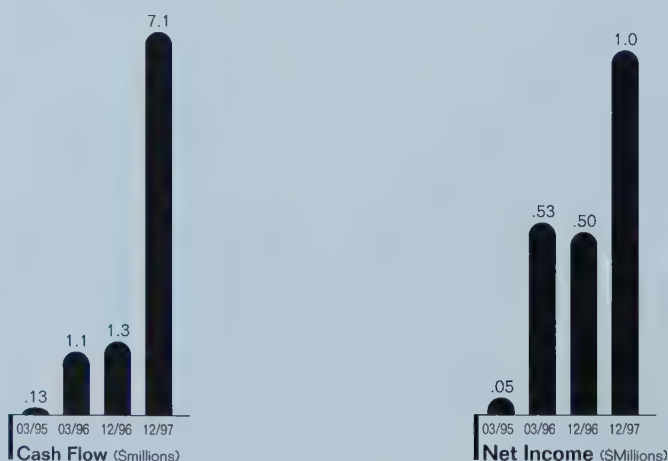
Storm's cash flow from operations increased 292% to \$7,054,046 in 1997 or \$0.152 per share (\$0.122 fully diluted) compared to \$1,348,081 or \$0.063 per share (\$0.047 fully diluted) in 1996. Because 80% of 1997's average production was light sweet crude oil, Storm achieved a cash flow netback of \$12.66/Boe in 1997.

### Depletion and Depreciation

Expenses for depletion, depreciation, and site restoration increased to \$4,968,282 from \$576,534 in 1996. This increase was due to the much higher oil and gas production volumes in 1997, larger depreciation costs due to the significant expenditures made on facilities and equipment, and higher industry costs. On a Boe basis, the depletion rate was \$8.82 compared to \$5.13 in 1996. Site restoration costs contributed \$44,582 to the 1997 total compared to \$18,698 in 1996. Storm, as required under the full cost method of accounting for petroleum and natural gas properties, completes an annual ceiling test. This test ensures that future net revenue from petroleum and natural gas reserves, using year end and average pricing, exceed estimated capital expenditures net of deferred taxes, future general and administrative costs related to production of those reserves, financing costs, and income taxes. As a result of the test conducted as of December 31, 1997, a substantial cushion was calculated. Crude oil prices would have to decrease by more than \$7.44/Bbl from the reported 1997 average price (\$25.27/Bbl) before a write-down would have to be considered.

### Net Earnings

Net income from operations for the year was \$1,001,415 or \$0.022 per share (\$0.017 fully diluted) compared to \$500,793 or \$0.023 per share (\$0.019 fully diluted) in 1996. On a Boe basis, net earnings in 1997 were \$1.80 compared to \$4.82 in 1996 due primarily to the increased 1997 interest on long term debt and depletion, depreciation and site restoration costs.



**Corporate Netbacks (\$/Boe)**

|                                                 | Twelve months<br>ending<br>Dec. 31, 1997 | Nine months<br>ending<br>Dec. 31, 1996 | Twelve months<br>ending<br>Mar. 31, 1996 |
|-------------------------------------------------|------------------------------------------|----------------------------------------|------------------------------------------|
| Corporate Price                                 | 24.75                                    | 25.70                                  | 19.82                                    |
| Royalties                                       | 4.85                                     | 4.49                                   | 1.71                                     |
| Operating                                       | 4.95                                     | 5.55                                   | 3.85                                     |
| Field Netback                                   | 14.95                                    | 15.66                                  | 14.26                                    |
| G&A                                             | 1.47                                     | 2.69                                   | 1.06                                     |
| Large Corporations tax                          | 0.10                                     | 0.00                                   | 0.00                                     |
| Cash Flow Netback                               | 12.66                                    | 12.97                                  | 13.20                                    |
| Depletion, Depreciation<br>and Site Restoration | 8.92                                     | 5.55                                   | 3.47                                     |
| Deferred Taxes                                  | 1.95                                     | 2.60                                   | 3.57                                     |
| Net Earnings                                    | 1.80                                     | 4.82                                   | 6.16                                     |

**FINANCIAL HEDGING TRANSACTIONS****Oil Production**

During 1997, Storm forward sold 6,000 barrels of oil per month from September 1, 1997 to December 31, 1997 at US\$20.48/Bbl and 6,200 barrels of oil per month from April 1, 1997 to March 31, 1998 at \$26.63/Bbl. Also, 12,000 barrels of oil per month were forward sold from January 1, 1998 to December 31, 1998 at US\$20.05/Bbl. Monthly settlements for gains or losses were included in oil revenues. As of December 31, 1997, these forward sales resulted in a net loss of \$56,758 during 1997 (\$0.10/Bbl). These transactions were done to protect the company from a potential drop in world oil prices thereby ensuring the company a predictable rate of cash flow throughout the year.

**CAPITAL EXPENDITURES (\$ Thousands)**

|                                | Twelve months<br>ending<br>Dec. 31, 1997 | Nine months<br>ending<br>Dec. 31, 1996 | Twelve months<br>ending<br>Mar. 31, 1996 |
|--------------------------------|------------------------------------------|----------------------------------------|------------------------------------------|
| Land                           | 1,020                                    | 392                                    | 30                                       |
| Seismic                        | 545                                      | 203                                    | 405                                      |
| Drill and completion           | 6,020                                    | 1,846                                  | 937                                      |
| Total Finding Costs            | 7,585                                    | 2,441                                  | 1,372                                    |
| Facilities and Equipment       | 3,733                                    | 627                                    | 459                                      |
| Acquisitions                   | 27,203                                   | 1,400                                  | 0                                        |
| Total Finding & Onstream Costs | 38,521                                   | 4,468                                  | 1,831                                    |
| Office Equipment               | 52                                       | 15                                     | 19                                       |
| Total Capital Costs            | 38,573                                   | 4,483                                  | 1,850                                    |



**FINDING AND ONSTREAM COSTS (\$/Boe @ 10:1)**

|                                          | 1997  | 1994 - 1996 | 1994 - 1997 |
|------------------------------------------|-------|-------------|-------------|
| Finding Costs                            |       |             |             |
| Proven                                   | 8.88  | 3.24        | 5.67        |
| Proven and Probable                      | 6.87  | 2.15        | 3.85        |
| Net Acquisition Costs                    |       |             |             |
| Proven                                   | 7.82  | 6.35        | 7.46        |
| Proven and Probable                      | 6.92  | 6.27        | 6.67        |
| Acquisition, Finding and On-Stream Costs |       |             |             |
| Proven                                   | 10.60 | 4.65        | 8.83        |
| Proven and Probable                      | 9.60  | 3.35        | 7.43        |
| Operational Netbacks                     | 14.95 | 15.66       | 14.95       |
| Reserve Recycle Ratio                    |       |             |             |
| Proven                                   | 1.4   | 3.4         | 1.7         |
| Proven and Probable                      | 1.6   | 4.7         | 2.0         |

The increase in finding and onstream costs in 1997 were related to the 259% increase in gross land holdings, the 252% increase in total seismic inventory, higher drilling and industry service costs, and the reserve revisions noted earlier.

**ESTIMATED TAX POOLS AS AT DECEMBER 31, 1997**

(\$ Thousands)

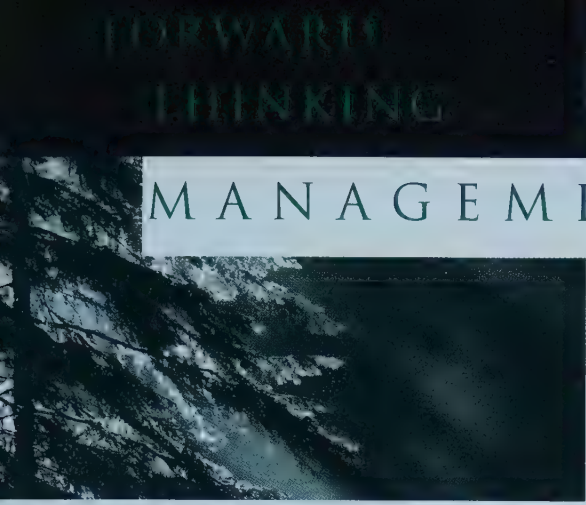
|                                                |        |
|------------------------------------------------|--------|
| Canadian oil and gas property expenses (COGPE) | 21,177 |
| Canadian exploration expenses (CEE)            | 3,434  |
| Canadian development expenses (CDE)            | 4,711  |
| Undepreciated capital costs (UCC)              | 9,303  |
| Total                                          | 38,625 |

Except for large corporation tax, Storm paid no taxes for the year ended December 31, 1997, and expects to remain in the same position in 1998 given budgeted capital expenditures.

**PLANNING FOR THE YEAR 2000**

Much has been written about the potential problem that companies may have with their computer programs in the year 2000. The concern arises because most of today's programs have a two-digit field to denote the year. For example, 1998 is coded as "98" in current programs and "00" will continue to be read as the year 1900 not the year 2000 unless the program is modified. Storm currently uses a commercial computer program (which is also used by many intermediate oil and gas companies) to do all of its financial accounting. The firm responsible for this program has assured Storm that they are addressing the "2000 problem" and that their program will be modified and tested late in 1998.

Storm does not anticipate that the areas of production accounting and field operations will be affected because date sensitivities do not exist on the computer programs that perform these functions at the present time. If Storm decides to update their present computer applications, Storm will choose programs with a four-digit field to denote the year.



# FORWARD THINKING MANAGEMENT'S REPORT

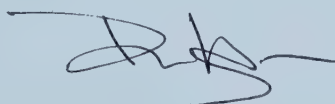
The financial statements of Storm Energy Inc. were prepared by management in accordance with generally accepted accounting principles in Canada. Management used estimates and careful judgement, particularly in those circumstances where transactions affecting current periods are dependent on information not known for certain until a future period. The financial and operational information contained in this annual report is consistent with that reported in the financial statements.

Management is responsible for the integrity of the financial and operational information contained in this report. The Company has designed and maintains internal controls to provide reasonable assurance that assets are properly safeguarded and that the financial records are well maintained and provide relevant, timely and reliable information to management. The financial statements have been prepared within reasonable limits of materiality and within the framework of the significant accounting policies as summarized in the notes to the financial statements.

External auditors appointed by the shareholders have conducted an independent examination of the corporate and accounting records in order to express their opinion on the financial statements. The Audit Committee, consisting of non-management directors, has met with the external auditors and management in order to determine if management has fulfilled its responsibilities in the preparation of the financial statements. The financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.



Daniel J. Tessari  
President and Chief Executive Officer



Ronald S. Hozjan  
Vice President Finance and  
Chief Financial Officer



# AUDITORS' REPORT

## To the Shareholders of Storm Energy Inc.

We have audited the balance sheets of Storm Energy Inc. as at December 31, 1997 and 1996, and the statements of income and retained earnings and changes in financial position for the year ended December 31, 1997 and the nine months ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996, and the results of its operations and the changes in its financial position for the year ended December 31, 1997 and the nine months ended December 31, 1996 in accordance with generally accepted accounting principles.

*Ernst & Young*

Calgary, Canada

January 16, 1998

Chartered Accountants

# BALANCE SHEETS

As at December 31

1997

1996

\$

\$

## Assets [note 4]

### Current

|                                 |                   |                  |
|---------------------------------|-------------------|------------------|
| Cash and short term investments | 250,125           | 365,189          |
| Accounts receivable             | 3,891,381         | 673,587          |
| Prepaid expenses                | 33,433            | 17,398           |
|                                 | <u>4,174,939</u>  | <u>1,056,174</u> |
| Property and equipment [note 2] | 39,927,773        | 6,277,749        |
|                                 | <u>44,102,712</u> | <u>7,333,923</u> |

## Liabilities and shareholders' equity

### Current

|                                                |            |           |
|------------------------------------------------|------------|-----------|
| Accounts payable and accrued liabilities       | 5,686,543  | 1,108,713 |
| Long term debt [note 4]                        | 15,000,000 | —         |
| Provision for site restoration and abandonment | 73,475     | 28,893    |
| Deferred income taxes [note 6]                 | 1,019,449  | 475,423   |

### Contingent liability [note 10]

### Shareholders' equity

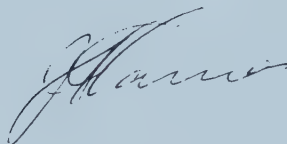
|                        |                   |                  |
|------------------------|-------------------|------------------|
| Share capital [note 5] | 20,475,579        | 4,874,643        |
| Retained earnings      | 1,847,666         | 846,251          |
|                        | <u>22,323,245</u> | <u>5,720,894</u> |
|                        | <u>44,102,712</u> | <u>7,333,923</u> |

See accompanying notes

On behalf of the Board:



Director



Director



# STATEMENTS OF INCOME AND RETAINED EARNINGS

Year ended December 31, 1997 and nine months ended December 31, 1996

|                                                | 1997<br>\$        | 1996<br>\$       |
|------------------------------------------------|-------------------|------------------|
| <b>Revenue</b>                                 |                   |                  |
| Production income                              | 13,791,968        | 2,656,570        |
| Royalties                                      | (3,022,348)       | (730,295)        |
| Alberta royalty tax credit                     | 321,425           | 263,557          |
| Other                                          | 248,570           | 14,581           |
|                                                | <u>11,339,615</u> | <u>2,204,413</u> |
| <b>Expenses</b>                                |                   |                  |
| Production                                     | 3,009,002         | 576,511          |
| General and administrative                     | 817,012           | 279,821          |
| Interest on long term debt                     | 399,482           | —                |
| Depletion and depreciation                     | 4,923,700         | 557,836          |
| Provision for site restoration and abandonment | 44,582            | 18,698           |
|                                                | <u>9,193,778</u>  | <u>1,432,866</u> |
| <b>Income before income taxes</b>              | <u>2,145,837</u>  | <u>771,547</u>   |
| <b>Income taxes [note 6]</b>                   |                   |                  |
| Deferred                                       | 1,084,349         | 270,754          |
| Large corporations tax                         | 60,073            | —                |
|                                                | <u>1,144,422</u>  | <u>270,754</u>   |
| <b>Net income for the period</b>               | <u>1,001,415</u>  | <u>500,793</u>   |
| <b>Retained earnings, beginning of period</b>  | <u>846,251</u>    | <u>345,458</u>   |
| <b>Retained earnings, end of period</b>        | <u>1,847,666</u>  | <u>846,251</u>   |
| <b>Net income per share [note 8]</b>           |                   |                  |
| Basic                                          | <u>0.022</u>      | <u>0.023</u>     |

See accompanying notes

# STATEMENTS OF CHANGES IN FINANCIAL POSITION

Year ended December 31, 1997 and nine months ended December 31, 1996

|                                                                                         | 1997<br>\$          | 1996<br>\$         |
|-----------------------------------------------------------------------------------------|---------------------|--------------------|
| <b>Operating activities</b>                                                             |                     |                    |
| Net income for the period                                                               | 1,001,415           | 500,793            |
| Add non-cash items:                                                                     |                     |                    |
| Depletion and depreciation                                                              | 4,923,700           | 557,836            |
| Provision for site restoration and abandonment                                          | 44,582              | 18,698             |
| Deferred income taxes                                                                   | 1,084,349           | 270,754            |
|                                                                                         | <u>7,054,046</u>    | <u>1,348,081</u>   |
| Net change in non-cash working capital items <i>[note 7]</i>                            | <u>(1,679,433)</u>  | <u>(62,930)</u>    |
|                                                                                         | <u>5,374,613</u>    | <u>1,285,151</u>   |
| <b>Financing activities</b>                                                             |                     |                    |
| Net proceeds from issuance of common shares                                             | —                   | 3,691,473          |
| Common shares issued to acquire Dancap,<br>net of issue costs                           | 2,515,565           | —                  |
| Common shares issued to acquire property<br>and equipment, net of issue costs           | 12,869,820          | —                  |
| Increase to long term debt to acquire<br>property and equipment                         | 15,000,000          | —                  |
| Proceeds from exercise of share options                                                 | 215,520             | —                  |
| Deferred income tax benefit arising on<br>share issue costs                             | (540,323)           | —                  |
| Shares redeemed for cash                                                                | —                   | (92)               |
|                                                                                         | <u>30,060,582</u>   | <u>3,691,381</u>   |
| <b>Investing activities</b>                                                             |                     |                    |
| Property and equipment additions                                                        | (36,321,444)        | (4,628,218)        |
| Acquisition of net assets of Dancap <i>[note 3]</i>                                     | (2,229,698)         | —                  |
| Acquisition of net assets of Long Reef <i>[note 3]</i>                                  | (22,551)            | —                  |
| Net change in non-cash working capital items <i>[note 7]</i>                            | <u>3,023,434</u>    | <u>217,152</u>     |
|                                                                                         | <u>(35,550,259)</u> | <u>(4,411,066)</u> |
| <b>Increase (decrease) in cash and short term<br/>    investments during the period</b> | <u>(115,064)</u>    | <u>565,466</u>     |
| Cash and short term investments, beginning of period                                    | <u>365,189</u>      | <u>(200,277)</u>   |
| <b>Cash and short term investments, end of period</b>                                   | <u>250,125</u>      | <u>365,189</u>     |

See accompanying notes



# NOTES TO FINANCIAL STATEMENTS

As at December 31, 1997 and December 31, 1996

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Company have been prepared in accordance with generally accepted accounting principles. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of estimates and approximations which have been made using careful judgment. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

### **Property and equipment**

#### ***Petroleum and natural gas properties and equipment***

The Company follows the full cost method of accounting in accordance with the guidelines issued by the Canadian Institute of Chartered Accountants whereby all costs associated with the exploration for and development of petroleum and natural gas reserves, whether productive or unproductive, are capitalized in a Canadian cost centre and charged to income as set out below. Such costs include lease acquisition, drilling, geological and geophysical equipment costs and overhead expenses related to exploration and development activities. Costs of acquiring and evaluating unproved properties are excluded from depletion calculations until it is determined whether or not proved reserves are attributable to the properties or impairment occurs.

Gains or losses are not recognized upon disposition of petroleum and natural gas properties unless crediting the proceeds against accumulated costs would result in a change in the rate of depletion of 20% or more.

Depletion of petroleum and natural gas properties and depreciation of production equipment is provided on accumulated costs using the unit of production method based on estimated proved petroleum and natural gas reserves, before royalties, as determined by independent engineers. For purposes of the depletion calculation, proven petroleum and natural gas reserves, before royalties, are converted to a common unit of measure on the basis of one barrel of oil or liquids being equal to ten mcf of natural gas.

The depletion and depreciation cost base includes total capitalized costs, less costs of unproved properties, plus provision for future development costs of proved undeveloped reserves.

The net carrying value of the Company's petroleum and natural gas properties is limited to an ultimate recoverable amount. This amount is the aggregate of estimated future net revenues from proved reserves and the costs of unproved properties, net of impairment allowances, less future estimated production costs, general and administrative costs, financing costs, future removal and site restoration costs and income taxes. Future net revenues are estimated using prices and costs without escalation or discounting, and the income tax and Alberta Royalty Tax Credit legislation in effect at the year end.

***Office furniture and equipment***

Office furniture and equipment are recorded at cost and are depreciated on the declining balance basis using rates varying from 7% to 100%.

***Leasehold improvements***

Leasehold improvements are recorded at cost and are depreciated on a straight-line basis over the lease term, including one renewal period.

***Provision for site restoration and abandonment***

Provisions for future site restoration and abandonment are made over the life of the Company's oil and gas properties using a unit of production basis. The estimate includes the cost of equipment removal, net of salvage value, and environmental clean-up in accordance with current costs, anticipated methods, existing legislation and industry practice. Actual expenditures are charged against the provision as incurred.

***Joint operations***

The accounts of the Company reflect its proportionate interest in exploration and production activities conducted jointly with others.

***Income taxes***

The Company follows the tax allocation method of accounting for income taxes. Under this method, provision is made for income taxes deferred principally as a result of claiming exploration and development cost and capital costs allowances for income tax purposes in excess of the depletion and depreciation provisions recorded in the accounts.

***Measurement uncertainty***

The amounts recorded for depletion and depreciation of property and equipment and the provision for site restoration and abandonment are based on estimates of reserves and future costs. By their nature, these estimates and those related to the future cash flows used to assess impairment, are subject to measurement uncertainty and the impact on the financial statements of changes in such estimates in future periods could be material.



## Financial instruments

The Company utilizes derivative financial instrument contracts to reduce its exposure to commodity price fluctuations. These contracts are designated and are effective as hedges and are not utilized for speculative purposes. Payments and receipts on these contracts are recognized in sales revenues at the time of sale of the related production.

## 2. PROPERTY AND EQUIPMENT

|                                                       | Dec. 31, 1997     |                                              | Dec. 31, 1996    |                                              |
|-------------------------------------------------------|-------------------|----------------------------------------------|------------------|----------------------------------------------|
|                                                       | Cost              | Accumulated<br>Depletion and<br>Depreciation | Cost             | Accumulated<br>Depletion and<br>Depreciation |
| Petroleum and natural gas<br>properties and equipment | 45,548,547        | 5,745,752                                    | 7,027,026        | 830,542                                      |
| Office furniture and equipment                        | 141,922           | 44,531                                       | 89,843           | 41,531                                       |
| Leasehold improvements                                | 51,382            | 23,795                                       | 51,262           | 18,309                                       |
|                                                       | <u>45,741,851</u> | <u>5,814,078</u>                             | <u>7,168,131</u> | <u>890,382</u>                               |
| Net book value                                        | <u>39,927,773</u> |                                              | <u>6,277,749</u> |                                              |

General and administrative costs capitalized for the year ended December 31, 1997 directly related to exploration activity totaled \$343,423 (1996 - \$138,750). Undeveloped property costs of \$1,389,378 (1996 - \$427,641) were excluded from the depletion base at December 31, 1997.

## 3. BUSINESS ACQUISITIONS

### a) Acquisition of Evi properties

On May 31, 1997 the Company completed an acquisition of certain petroleum and natural gas properties in the Evi area of Alberta for a purchase price of \$23.3 million less adjustments to February 1, 1997. For accounting purposes, the Company used the effective date of March 1, 1997.

### b) Purchase of Dancap Resources Inc.

On June 10, 1997, Dancap Resources Inc. ("Dancap"), a public company traded on the Alberta Stock Exchange, acquired all of the shares of Storm Energy Corporation ("Storm") in exchange for shares of Dancap, resulting in the issuance of 52.2 million common shares. Dancap assets included a 50% ownership in Long Reef Resources Inc., a private company. Under this transaction, the former shareholders of Storm acquired control of Dancap resulting in a reverse takeover, whereby Storm is deemed to be the acquirer of Dancap for accounting purposes, with an effective date of June 1, 1997.

The acquisition of Dancap has been accounted for using the purchase method of accounting, whereby the purchase price in excess of the carrying value of the net assets acquired has been allocated to property and equipment. The purchase price has been allocated as follows:

|                                                                           | \$               |
|---------------------------------------------------------------------------|------------------|
| Non-cash working capital                                                  | 188,130          |
| Property and equipment<br>(including allocation of excess purchase price) | 2,689,780        |
| Deferred financing costs                                                  | 11,788           |
| Long term debt                                                            | (660,000)        |
| Subtotal                                                                  | 2,229,698        |
| Cash                                                                      | 313,557          |
| Purchase price                                                            | <u>2,543,225</u> |

**c) Purchase of Long Reef Resources Inc.**

On October 31, 1997, the Company acquired the 50% interest it did not already own in Long Reef Resources Inc. from a related party for \$50,050. The acquisition has been accounted for using the purchase method of accounting, whereby the purchase price in excess of the carrying value of the net assets acquired has been allocated to property and equipment. The purchase price has been allocated as follows:

|                                                                           | \$            |
|---------------------------------------------------------------------------|---------------|
| Non-cash working capital                                                  | 49,622        |
| Property and equipment<br>(including allocation of excess purchase price) | 304,325       |
| Deferred financing costs                                                  | 8,604         |
| Long term debt                                                            | (340,000)     |
| Subtotal                                                                  | 22,551        |
| Cash                                                                      | 27,499        |
| Purchase price                                                            | <u>50,050</u> |

**d) Amalgamation**

Subsequent to the transactions described in b) and c) above, Storm Energy Inc. (formerly Dancap Resources Inc), Storm Energy Corporation and Long Reef Resources Inc. were amalgamated and continued operations under the name of Storm Energy Inc.

**4. BANK CREDIT FACILITY**

The Company has a revolving term credit facility available up to \$17,500,000 with a Canadian bank. Under the facility, loan advances bear interest, payable monthly, at the bank's prime rate plus 1/4%. A floating charge demand debenture in the amount of \$30,000,000 covering all of the assets of the Company and a general security agreement have been pledged as collateral. The average interest rate on the amount drawn during the year was 5.2%. In March 1998, the bank will review the facility. It is management's intention to renegotiate this facility to extend it past the 1998 fiscal year.



## 5. SHARE CAPITAL

### a) Authorized

An unlimited number of voting common shares

An unlimited number of preferred shares

### b) Issued

|                                                                                          | Number of<br>Shares | Consideration<br>\$ |
|------------------------------------------------------------------------------------------|---------------------|---------------------|
| <b>Common shares</b>                                                                     |                     |                     |
| Balance as at December 31, 1996                                                          | 10,100,000          | 1,045,506           |
| Issued upon conversion of special warrants<br><i>[see (c) below]</i>                     | 5,866,666           | 3,829,137           |
| Issued for cash                                                                          | 8,450,000           | 13,520,000          |
|                                                                                          | 24,416,666          | 18,394,643          |
| Issued to acquire Dancap <i>[note 3 (b)]</i>                                             | 13,584,333          | 2,543,255           |
| Issue costs related to financing and Dancap<br>acquisition, net of deferred tax benefits | —                   | (677,839)           |
| Increase in shares due to conversion on reverse<br>takeover of Dancap <i>[note 3(b)]</i> | 27,767,922          | —                   |
| Issued upon exercise of<br>stock options <i>[see (c) below]</i>                          | 729,934             | 215,520             |
| <b>Balance as at December 31, 1997</b>                                                   | <b>66,498,855</b>   | <b>20,475,579</b>   |
| <b>Special warrants</b>                                                                  |                     |                     |
| Balance as at December 31, 1996                                                          | 5,333,333           | 3,829,137           |
| Converted to common shares <i>[see (c) below]</i>                                        | (5,333,333)         | (3,829,137)         |
| <b>Balance as at December 31, 1997</b>                                                   | <b>Nil</b>          | <b>Nil</b>          |

### c) Special warrants

During 1996 the Company issued 5,333,333 Special Warrants at a price of \$0.75 per warrant for net proceeds of \$3,829,137. These special warrants were exercised in 1997, resulting in the issuance of 1.1 common shares for each warrant exercised.

In addition to the Special Warrants described above, 266,667 options were issued in 1996 to the Agent for the Special Warrants placement. These options entitled the holder to purchase common shares at an exercise price of \$0.75 per share. These options were exercised in 1997, resulting in the issuance of 569,934 common shares (after reflecting the share conversion on the Dancap acquisition) for proceeds of \$200,000.



#### d) Share options

The Company has reserved 6,649,885 shares for share options, of which 4,161,586 have been issued to certain directors, officers and employees as follows:

| Number of common<br>shares under option | Exercise price per<br>common share | Date of expiry     |
|-----------------------------------------|------------------------------------|--------------------|
| 240,000                                 | 0.10                               | March 31, 1999     |
| 1,773,918                               | 0.0936                             | June 30, 2000      |
| 220,000                                 | 0.15                               | July 8, 2000       |
| 190,000                                 | 0.15                               | October 10, 2000   |
| 64,118                                  | 0.3509                             | July 31, 2001      |
| 240,588                                 | 0.0936                             | September 23, 2001 |
| 74,804                                  | 0.3509                             | September 23, 2001 |
| 65,000                                  | 0.60                               | August 6, 2002     |
| 713,137                                 | 0.75                               | August 26, 2002    |
| 440,021                                 | 0.58                               | August 26, 2002    |
| 40,000                                  | 0.70                               | September 30, 2002 |
| 40,000                                  | 0.75                               | October 16, 2002   |
| 60,000                                  | 0.75                               | December 16, 2002  |
| <u>4,161,586</u>                        |                                    |                    |

#### 6. INCOME TAXES

The provision for income taxes is different from the amount computed by applying the combined statutory Canadian Federal and Provincial tax rates to income for the period before income taxes. The differences are as follows:

|                                                                      | Year ended<br>Dec. 31, 1997 | Nine months ended<br>Dec. 31, 1996 |
|----------------------------------------------------------------------|-----------------------------|------------------------------------|
| Effective income tax rate                                            | 44.62%                      | 44.62%                             |
| Expected provision for income taxes                                  | 957,472                     | 344,264                            |
| Add (deduct) the income tax effect of:                               |                             |                                    |
| Non-deductible crown charges                                         | 1,088,440                   | 205,139                            |
| Resource allowance                                                   | (758,787)                   | (170,346)                          |
| Alberta royalty tax credit                                           | (143,420)                   | (117,599)                          |
| Difference between income tax and accounting<br>claims for depletion | (63,703)                    | 6,617                              |
| Other                                                                | 4,347                       | 2,679                              |
|                                                                      | <u>1,084,349</u>            | <u>270,754</u>                     |

As at December 31, 1997, the Company has exploration and development costs and capital cost allowances available for deduction against future taxable income totalling approximately \$38,000,000.



## 7. CHANGES IN NON-CASH WORKING CAPITAL ITEMS

|                                                   | Year ended<br>Dec. 31, 1997 | Nine months ended<br>Dec. 31, 1996 |
|---------------------------------------------------|-----------------------------|------------------------------------|
| Accounts receivable                               | 3,217,794                   | (580,017)                          |
| Prepaid expenses                                  | 16,035                      | (10,489)                           |
| Accounts payable and accrued liabilities          | (4,577,830)                 | 744,728                            |
| Change in non-cash working capital                | (1,344,001)                 | 154,222                            |
| These changes relate to the following activities: |                             |                                    |
| Operating activities                              | 1,679,433                   | (62,930)                           |
| Investing activities                              | (3,023,434)                 | 217,152                            |
|                                                   | (1,344,001)                 | 154,222                            |

## 8. NET INCOME PER SHARE

Net income for the period per share is calculated using the weighted average number of shares outstanding during the year. Fully diluted net income for the period per share is calculated on the basis of the weighted average number of common shares that would have been outstanding during the year had all stock options and warrants been exercised at the date of their issuance. Fully diluted net income for the period per share was anti-dilutive in 1997 and 1996.

## 9. FINANCIAL INSTRUMENTS

Financial instruments of the Company consist mainly of cash and short term investments, accounts receivable and payable and long term debt. As at December 31, 1997 there are no significant differences between the carrying amounts reported on the balance sheet and their estimated market value.

At December 31, 1997, the Company also had a forward contract outstanding to sell 200 barrels per day at a fixed price of \$26.63 per barrel, expiring March 31, 1998. Based on dealer quotes, had this contract been closed out at December 31, 1997, the Company would have received a payment of \$20,520.

Subsequent to December 31, 1997, the Company entered into a contract to further hedge an additional 400 barrels of oil per day at a fixed price of \$20.05 USD per barrel for fiscal 1998.

## 10. CONTINGENT LIABILITY

During the year, the Company was served a statement of claim which alleges that a Right of First Refusal ("ROFR") was exercised on certain of the Evi properties acquired by Storm (see Note 3(a)), and that the vendor was therefore not legally entitled to sell such properties to Storm. The Company, on the advice of its legal counsel, feels the claim is without merit and a counterclaim has been filed. No provision has been made for the amounts claimed.



## **CORPORATE INFORMATION**

### **Officers and Key Personnel**

Daniel J. Tessari

*President and Chief Executive Officer*

Ronald S. Hozjan

*Vice-President Finance and Chief Financial Officer*

David K. Christensen

*Vice-President, Engineering*

Stephen N. Ewaskiw

*Vice-President, Exploration*

John A. Brussa

*Secretary*

### **Board of Directors**

J. Keith Farries, *Chairman*

John A. Brussa

Stephen N. Ewaskiw

D. Keith MacDonald, *Vice-Chairman*

A. Gordon Stollery

Daniel J. Tessari

Robert M. Tessari

### **Executive Offices**

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Calgary, Alberta, Canada

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Facsimile: (403) 266-6209

E-Mail: [stormnrg@cadvision.com](mailto:stormnrg@cadvision.com)

Website: [stormenergy.com](http://stormenergy.com)

### **Auditors**

Ernst & Young

Calgary, Alberta

### **Solicitors**

Burnet, Duckworth & Palmer

Calgary, Alberta

### **Registrar and Transfer Agent**

Montreal Trust

Calgary, Alberta

### **Banker**

Alberta Treasury Branch

Main Branch

Calgary, Alberta

### **Stock Listing**

Alberta Stock Exchange

Trading Symbol "SME"

### **Shares Outstanding (March 1/98)**

Basic 66,561,339

Fully Diluted 70,660,441





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Calgary, Alberta, Canada  
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